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Mastering the art of value-capture in M&A

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Mastering the art of value-capture in M&A

By Ravi Chanmugam, Walter E. Shill and David Mann

Mergers that create maximum value treat the transaction as a complete lifecycle—beginning with pre-deal strategy, progressing through deal execution and continuing with post-merger integration.

When Cingular Wireless and AT&T Wireless Services closed on their $41 billion merger in October 2004, the new entity hit the ground running. Training programs were launched; call centers were staffed with thousands of temporary customer service representatives to handle an anticipated spike in inquiries; and the two companies' IT systems were combined. And it all happened before the end of the first post-merger day of business.

How could so much be accomplished on Day One? Credit exceptional planning and execution. The two companies had meticulously designed their de novo entity, starting shortly after the merger was announced and continuing for the eight months leading up to the close—all the while remaining in full compliance with US Department of Justice rules governing M&A.

Not all such transactions go so well—and the costs of a merger done badly can be enormous. Given the size of many of today's deals, missing synergy goals by even a small amount can lead to the loss of hundreds of millions of dollars of shareholder value. Through our client work with more than 350 merger integration engagements during the past five years, as well as careful study of the larger M&A universe during that period, Accenture has learned what separates the best transactions from the mediocre (or worse) ones.

The most successful M&A transactions we have observed are characterized by the superior execution of an explicit value-capture strategy, which we call the "lifecycle approach." To achieve this, top managements in the most successful transactions have relied on four key principles.

Treat M&A as a holistic process

Many merger partners treat pre-deal and post-deal processes as discrete, often using entirely different teams before and after the transaction has been completed. This results in vague accountability, unnecessary handoffs, and a disconnect between the valuation and the financial goals of the merger.

The more successful, integrated approach treats the M&A transaction as a lifecycle that begins with pre-deal strategy (goals, target identification, valuation), progresses through deal execution, and continues with post-merger integration.

For example, when Hewlett-Packard Company acquired Compaq Computer Corporation, the Compaq management chose this integrated approach. Compaq used pre-merger planning to analyze, support and structure negotiations with HP, as well as to consider alternatives. Both companies used pre-close integration planning to identify, quantify and map out a course for pursuing the financial benefits of the transaction. And they used post-close execution resources to actually realize those benefits.

All three stages were seen as part of a whole, and more than 30 task forces worked on the project. The reward: The combined company realized one of its main targets—a $2.5 billion cost synergy—a full year ahead of schedule.

A holistic approach can even help save a company money before a deal is struck. The value of the deal, and the appropriate bid, are defined in

terms of what cash flow will be required to make the deal a success. And during execution, synergy targets are better aligned with the required premium. As a result, the integration of the companies is focused on the key value-creating drivers that made the deal attractive in the first place.

Focus on value creation, not just integration

In our experience, most acquiring companies focus their attention on bringing the two entities together as quickly as possible. Yet we believe that the goal should be value creation, not just integration, and that integration activities should be prioritized according to the value they create.

For example, if the greatest value in a merger is cross-selling opportunities to the new base of common customers—as is often the case—the integration process needs to enable and ensure the rapid transfer of customer information and the development of integrated account plans. Lower-value activities can be postponed. This value-creating approach is more akin to business transformation, in its emphasis on unlocking value through meticulous planning and the process of proactively designing a new organization.

Many companies organize their integration activities on a functional basis rather than a value-added basis. While many functional activities must be consolidated (such as bringing databases together and rationalizing policies, procedures and IT systems), not all integration activities yield equal benefits. Blindly and aggressively integrating various functions and businesses without regard to a value-creating hierarchy can actually destroy value.

Consider the case of a $1 billion US technology company that had struggled for years before being bought by a much larger, more profitable company. The acquirer's merger team was astounded to find that the smaller company was sourcing and procuring many components for 10 percent to 20 percent less than the larger company. That unanticipated capability, incorporated into the parent company's business model, produced huge savings. Had the procurement function of the target

The "Intelligent Clean Room"

Successful execution of the lifecycle approach to merger integration (see story) boils down to tactical excellence. One of the most effective M&A tactics is what Accenture calls the "Intelligent Clean Room."

Earlier clean rooms were narrowly defined due-diligence mechanisms with which third-party experts could examine sensitive information on prospective M&A partners in a physically separate and legally isolated space. Accenture has updated the concept through the application of a value-capture perspective.

Rather than waiting until the deal formally closes, the Intelligent Clean Room allows detailed, side-by-side company analysis and integration planning before approvals are finalized. The analysis is done by third parties, not company employees, so the prospective merger partners can continue to act as competitors as required by US Department of Justice rules.

Working within DOJ limitations, the source and priority of many high-value synergy initiatives can be determined. Intelligent Clean Room processes can include the building of detailed financial models for assessing cost synergies on a business-unit basis or even a line-item basis, creating tools for tracking synergies, assisting the legal teams with regulatory findings, setting up post-merger governance models, and administering the overall project calendar.

For the Cingular Wireless and AT&T Wireless union, Accenture was engaged to design and conduct Intelligent Clean Room pre-merger planning. The stated objective was to capture maximum value in the critical first two years of post-merger operations. To this end, more than 40 professionals, with specialized skills—including sales and marketing, customer care, network experience, supply chain management, HR and IT—set up work at an Intelligent Clean Room in Atlanta. During the eight months from announcement to close, key aspects of the combined companies' business were examined, analyzed, modeled against value-capture objectives and assigned priorities. The process covered areas ranging from retail distribution to billing processes to advertising effectiveness.

The Intelligent Clean Room for Cingular and AT&T Wireless was significant for its use of explicitly defined "leading indicators"—anticipatory metrics such as dramatically increased call center volume or product returns. One working (and ultimately correct) premise, for example, was that traditional post-merger integration timelines to integrate systems and fix problems would be too long if customer defections ran high. The Cingular-AT&T Wireless team made preemptive use of daily and weekly interim data to identify and address problems before they became serious issues.

company been dismantled to speed up integration, the capability and the potential value it represented would have been lost.

Accelerate merger planning and execution

From the time a deal is announced, there is an approximately 24-month window that is critical. For a portion of that time, regulatory agencies are reviewing the deal, and the two merging entities are not allowed to collaborate on integration activities. For the top 20 deals announced from 1998 to 2003, it took national and transnational regulators 10 months on average to complete their reviews, a sizable chunk of time. Intense shareholder scrutiny also increases the time from announcement to closure. For example, broadband provider Comcast announced its $72 billion acquisition of AT&T Broadband in December 2001, but it was not until November 2002 that the deal was approved to close. Lengthier reviews have a number of implications for the companies involved—all negative.

These delays have direct financial impact. For an acquirer expecting to reap $500 million in yearly cost savings from an M&A transaction, a one-month delay reduces the net present value of the deal by more than $150 million (assuming a 10 percent cost of capital). A seven-month delay costs nearly $1 billion in lost value, or approximately $3.5 million per day. There are indirect financial repercussions as

Best practices

Leading M&A practitioners demonstrate an understanding of lifecycle principles in their merger integration work. Here are some of their best practices.

- Create overlap in the teams responsible for transaction valuation and synergy capture. Nothing results in more accurate estimates of merger performance than having them prepared by the people who will have to achieve them.
- Define synergies around value levers and activity-based cost efficiencies, instead of functions (for example, by reducing supply chain costs by 2 percent, rather than having functions cut expenses by some arbitrarily prescribed percentage).
- Formally incorporate time-delay calculations into the valuation process, placing a premium on the anticipation and preemption of delays during the preapproval process.
- Remember that systems and people seldom automatically scale up to a larger size. Use selective redundancy, doubling up or retaining executives in interim integration teams or as coaches in order to avoid unsustainable workloads.
- Consistently and actively "re-recruit" the best and the brightest of both organizations to minimize the loss of key personnel during the tough integration work through painful organizational decisions.

well, such as postponed business strategy implementation, diminished employee morale, and workforce or customer defections.

During Unilever's $26 billion acquisition of Bestfoods in 2000, senior management understood that there was value to be saved by setting a tight agenda to ensure the delivery of the targeted synergies. The acquisition was announced in June of that year but required approvals not only from US and European regulators—each of which took about four months—but also from agencies in nearly every other region in the world, including the Middle East and Africa. The longest took nearly 18 months.

In the interim, Unilever began to plan for Day One following final approval, for the first 100 days of the merger and for post-merger integration. The Day One PMI plan focused primarily on communications and high-profile appointments. The plan for the first 100 days addressed operational continuity. In addition, Unilever developed parallel assessments for its functional integration needs and its business integration needs, then combined the two into a single detailed work plan.

On the day the deal closed, all three plans were implemented. The Unilever approach enabled them, among other results, to deliver the expected synergies ahead of target.

BP used similar accelerated merger planning when it purchased Veba Oel AG in 2002. The company intended to take operational and financial control of Veba and apply BP policies across the new organization, avoiding business interruptions in the process. BP achieved major integration milestones on schedule, and the synergies during the first year exceeded expectations.

How do we define success?

From Accenture's point of view, M&A is an arena where one might expect wide consensus about what defines success: incremental cash flow returned in the form of increased shareholder value.

But this is not the case. We recently surveyed a number of senior executives about how they measure M&A success. Only 9 percent of them defined "success" as an increase in the free cash flow over the premium paid. On the other hand, more than 40 percent of them defined it in nonfinancial terms such as market share or portfolio expansion. From our perspective, these nonfinancial strategic definitions are valid only if they have a financial basis and can be clearly translated into financial outcomes.

The company was able to achieve this using three tools: synergy project charters, integration contracts and regular performance reviews with integration managers. The charters defined the overall scope, costs and benefits of each synergy project. The contracts were a formal commitment to the overall integration plan and were signed by the business unit leaders and functional unit heads. Contract signing was considered the formal passing of accountability for achieving the synergies and major integration milestones. And finally, the integration director conducted regular performance reviews to understand real delivery against the overall plan and to support the businesses and functions in delivering their promises, as well as to create an important link between the overall strategy of the integration and the front lines.

Use culture as a value-creation tool

Accenture recently asked the Economist Intelligence Unit to survey senior executives and managers on the topic of post-merger integration. "Cultural differences and cultural resistance" were cited most often by respondents as the thing that surprised them most during the post-merger integration process. This confirms our own experience, which suggests that even some management teams that identify cultural fault lines early on in the M&A process fail to incorporate their insights into the design of their merger integration.

There are exceptions. One global chemicals company captured value in a series of major acquisitions by using a consistent process to identify cultural intangibles, such as unwritten rules, in its acquired companies. It then compared the acquired companies' cultures with its own to understand how employees would react to various situations. Based on this in-depth understanding, the company then created tailored change management programs.

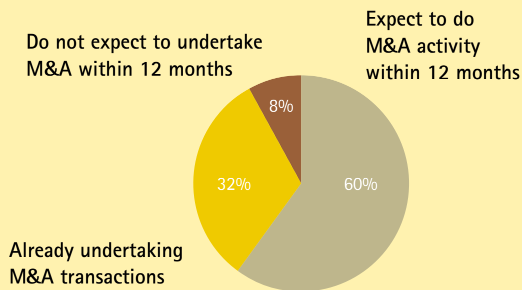
The chemicals company recognized that changing organizations can be stressful for employees. As a result, it consistently tried to make decisions on leadership changes quickly so that individuals understood their new roles. Because the company considers training and support to be critical, new employees spent up to 15 percent of their time during the first year after the acquisition in training.

High-tech communication was key in helping new employees quickly

The bigger picture

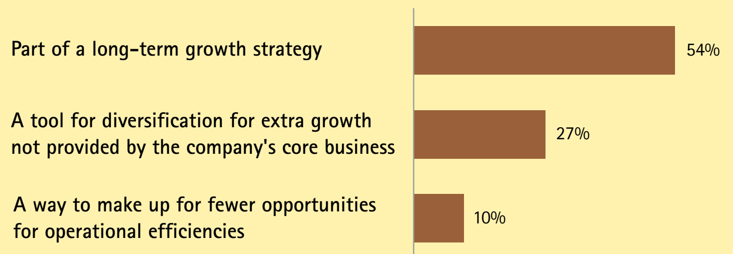
Plenty of M&A activity is expected within a year.

Percent of executives who:



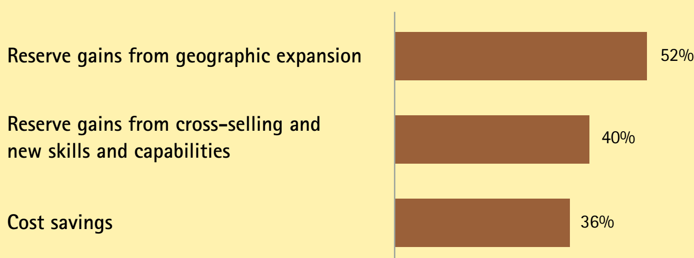
Executives see M&A as part of a company's ongoing growth strategy and as a means to diversify and compensate for fewer efficiency gains.

Percent of executives who see M&A as:



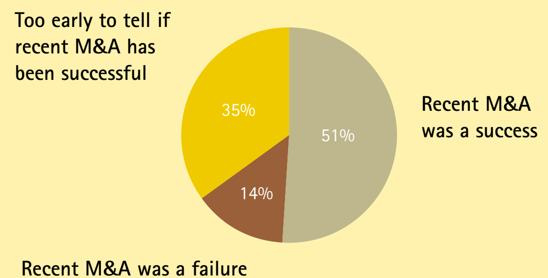
Executives see revenue gains as the main source of value creation from M&A.

Sources of value creation in M&A:



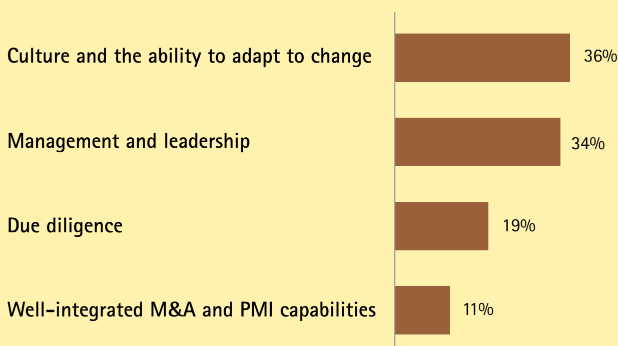
Recent M&A activity has been considered by half the executives polled as successful.

Percent of executives who think:



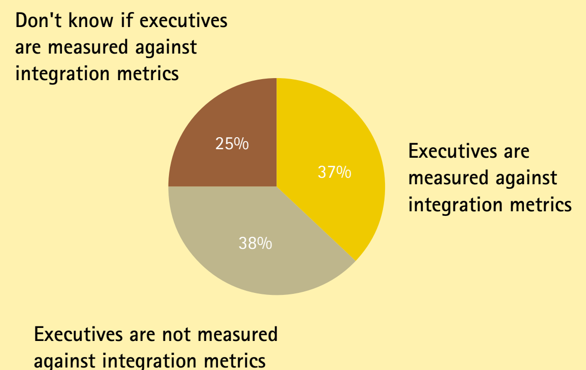
Culture and the ability to adapt to change are critical to success.

Executives perceive as most critical factor of success:



Many companies still don't measure executives against integration metrics.

Executives say that at their companies:



SOURCE: ECONOMIST INTELLIGENCE UNIT SURVEY; ACCENTURE ANALYSIS

feel like they were a part of the chemicals company. To this end, the company made a priority of installing standard workstations with intranet access, videoconferencing capabilities and satellite links at its acquired companies—and all within four months following its acquisitions.

The most successful acquirers of the future will see culture as a tool in three ways. First, they will look at cultural differences during the target identification and bidding phases, assess the potential impact of those differences, and incorporate their analysis into the valuation and bid. Second, they will try to avoid the pitfalls common during pre- and post-merger planning, and actively incorporate the elements of each company's culture that best support the desired combination. Finally, they will proactively use culture to create value through the use of high-visibility retention, promotion, termination and structural organizational design decisions.

As more and more companies opt to supplement organic growth with mergers and acquisitions, the earlier stages of M&A transactions are becoming relatively mature, commoditized processes. Differentiated performance and, ultimately, successful mergers will increasingly depend on the later stages of M&A transactions. This will be particularly true of merger integration, where the relentless and accelerated pursuit of value creation is still underappreciated—and underpracticed. ■

About the authors

Ravi Chanmugam is a New York-based partner in the Accenture Strategy/Mergers & Acquisitions group. With more than 10 years' experience in M&A and management consulting, Mr. Chanmugam's work focuses on M&A strategy, strategic due diligence, merger integration and corporate strategy.

ravi.chanmugam@accenture.com

Walter E. Shill is a Washington, D.C.-based partner in the Accenture Strategy/Organization & Change Strategy group. He has more than 15 years of experience across the spectrum of M&A deals and strategy consulting with Fortune 1000 clients and large private equity firms. Prior to joining Accenture, Mr. Shill was CEO of a reverse logistics company. He is a Betten Fellow at the Darden Graduate School of Business, and he serves on the boards of several technology and service companies.

walter.e.shill@accenture.com

David Mann is the lead partner for the Accenture Strategy/Products group in the United Kingdom. His work focuses on both pre- and post-merger engagements across various industries; he also helps clients with operating-model and corporate strategy development. Before joining Accenture, Mr. Mann was a practicing lawyer in Australia, where he worked on M&A engagements. He is based in London.

david.mann@accenture.com

Kristin Ficery, an Atlanta-based associate partner in the Accenture Strategy/Mergers & Acquisitions group, and **Bill Pursche**, an external specialist in merger planning, contributed to this article.

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